7.08 Nonmonetary Exchanges

Overview

In some cases, there may be an exchange of assets between entities that does not involve cash or cash equivalents, receivables, or payables. When these transactions are related to a contract with a customer, the guidelines for revenue recognition are followed, with the nonmonetary assets received treated as nonmonetary consideration. Otherwise, these transactions, referred to as *nonmonetary exchanges*, are generally recognized at **fair value.**

This general rule applies when the transaction has **commercial substance**. ASC 845 considers an exchange to have commercial substance whenever the *risk, timing, and/or amount of cash flows* are affected by the exchange.

There are three exceptions to the general rule, including when an exchange **lacks commercial substance**. In these circumstances, such nonmonetary exchanges are handled differently.

Exchanges with Commercial Substance (General Rule)

A nonmonetary exchange with commercial substance is treated as if it were two unrelated events:

1. Sale of the asset surrendered
2. Purchase of the asset received

The sales price of the **asset surrendered** is considered its fair value.

- If the fair value of the asset given is not readily determinable, the assumed sales price will be the fair value of the asset received plus any monetary consideration received or minus any monetary consideration given.
- If neither fair value is readily determinable, the assumed sales price will be the carrying value of the asset surrendered.

The **asset received** will be recognized at the sales price, minus any monetary consideration received, or plus any monetary consideration given. As a result, a **gain/loss** is recognized on the difference between the fair value and book value of the asset surrendered.

Nonmonetary Exchanges with Commercial Substance

- Recognize *all* gains and losses.
- Record new asset at FMV. If know #1 below, use it as the debit to the new asset. If #1 not known, use #2. If #2 not known, use #3.
  1. FMV given up + cash paid (– cash received)
  2. FMV of asset received
  3. Book Value (BV) given up + cash paid (– cash received)

Exchanges Lacking Commercial Substance (Exceptions)

Since nearly all exchanges will result in *some* change in future cash flows, **assume commercial substance** on all exam questions involving nonmonetary exchanges **unless**:

- The fair value of the assets received/relinquished cannot be determined within a reasonable limit.
- It's an exchange of assets sold in the *ordinary course of business* for assets sold in the same line of business (eg, inventory for inventory) to facilitate sales to third-party customers.
- Usually, such exchanges take place with a competitor or vendor merely to facilitate future sales to unrelated customers.
- The exchange lacks commercial substance (ie, cash flows are expected to be substantially unchanged as a result of the exchange).

In all three of these exceptions, the *carryover basis* (ie, book value, adjusted for the cash paid/received) is used to measure the transaction instead of the fair value. Gains are not recognized unless boot is received (discussed later). **Losses**, however, are reported in full.

Nonmonetary Exchanges Lacking Commercial Substance*

- Recognize all losses.
- Defer all gains, unless boot is received.
- Record at *lowest* of:
  1. FMV given up + cash paid (– cash received)
  2. FMV of asset received
  3. Book Value (BV) given up + cash paid (– cash received)

Debit asset for lowest of these three

**Includes all exceptions to the general rule.*

Four Examples: 2 examples with commercial substance and 2 lacking commercial substance.

- Cash paid out for Example A = $10.
- Cash paid out for Example B = $20.
- FMV of asset given up is unknown.
- FMV of new asset = $30.
- Book Value of asset given up = $15.

Example A: Substance		
New	30	
Old		15
Cash		10
Gain		5

Example B: Substance		
New	30	
Loss	5	
Old		15
Cash		20

1. ?
2. 30
3. **25**

Example A: Lack Substance		
New	**25**	
Old		15
Cash		10

Example B: Lack Substance		
New	**30**	
Loss	5	
Old		15
Cash		20

1. ?
2. **30**
3. 35

Lacks Commercial Substance – *BOOT Received*

There is one type of exchange lacking commercial substance in which **gain is recognized**, however, and that is when boot is received in an exchange. The reason for this difference is that the cash received results in a small amount of commercial substance, and that part of the transaction must be reported differently from the portion of the exchange that lacks it.

- Defer all gains unless boot is received, then recognize the gain up to the proportionate share of boot received to total consideration received. The ratio to use is total boot received / total consideration received (boot + FV of asset received), multiplied by the gain.
- When the boot received is ≥ 25% of the total consideration received (including the boot), the transaction is viewed as a monetary exchange and all the gain is recognized.

Assume a company receives inventory with an FMV of $8,000 and cash of $2,000, by giving up similar inventory with a book value of $6,000.

FMV Received	8,000	
+ Cash (boot) Received	2,000	= 2,000/10,000 (boot to total consideration received)
Total consideration rec'd	10,000	
– Book Value (BV) given up	(6,000)	
Realized Gain	4,000	
	× 20%	= 20% of proceeds are boot, so recognize 20% of gain
	800	

New (plugged)	4,800	
Cash	2,000	
Old		6,000
Gain		800

Summary

A nonmonetary exchange is recognized at fair value *unless:*

- Fair value is not determinable,
- The exchange is to facilitate sales to customers, or
- The exchange lacks commercial substance.

There are six different situations that need to be distinguished in determining whether *gains* (FMV exceeds carrying amount) and *losses* (carrying amount exceeds FMV) are recognized:

	Commercial Substance			Lacks Commercial Substance*		
Boot	**None**	**Paid**	**Received**	**None**	**Paid**	**Received**
Gain	Yes	Yes	Yes	No	No	Part
Loss	Yes	Yes	Yes	Yes	Yes	Yes

**Includes all exceptions to the general rule.*

Donations

On occasion, a company will receive an **asset as a donation** (ie, a nonreciprocal transfer). The receipt of the donated asset is generally treated as ordinary income for the fair market value of the asset. For example, if an individual donates land worth $3,000,000 to the company, the entry is:

Land	3,000,000	
Other income (contribution revenue)		3,000,000